

DOW THEORY LETTERS INC.

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THE PICTURE: People often ask me where or how I get my ideas on what to write about in these Letters. My answer has been the same since 1958, when I started this business. "I write about what I think about, worry about, what I feel good about or feel bad about. That's all I can do. If it interests me I feel there's a good chance it will interest my readers. If it sounds assinine to me, I imagine it will sound stupid to my subscribers, and consequently I leave it out. Personally, in reading dozens of advisories each week, I find that I am turned off by the analysts who write strictly off the top of their heads or purely out of their statistics. My feeling has always been this — no matter how big a genius you are, if people won't read the reports you put out, if they put your stuff down because they can't wade through it, then you've failed. In other words, what you write has got to interest people's heads and their guts. If you can't do that, then you better close shop, because you're just a bankruptcy looking for a place to happen. And that's what it's all about in this business."

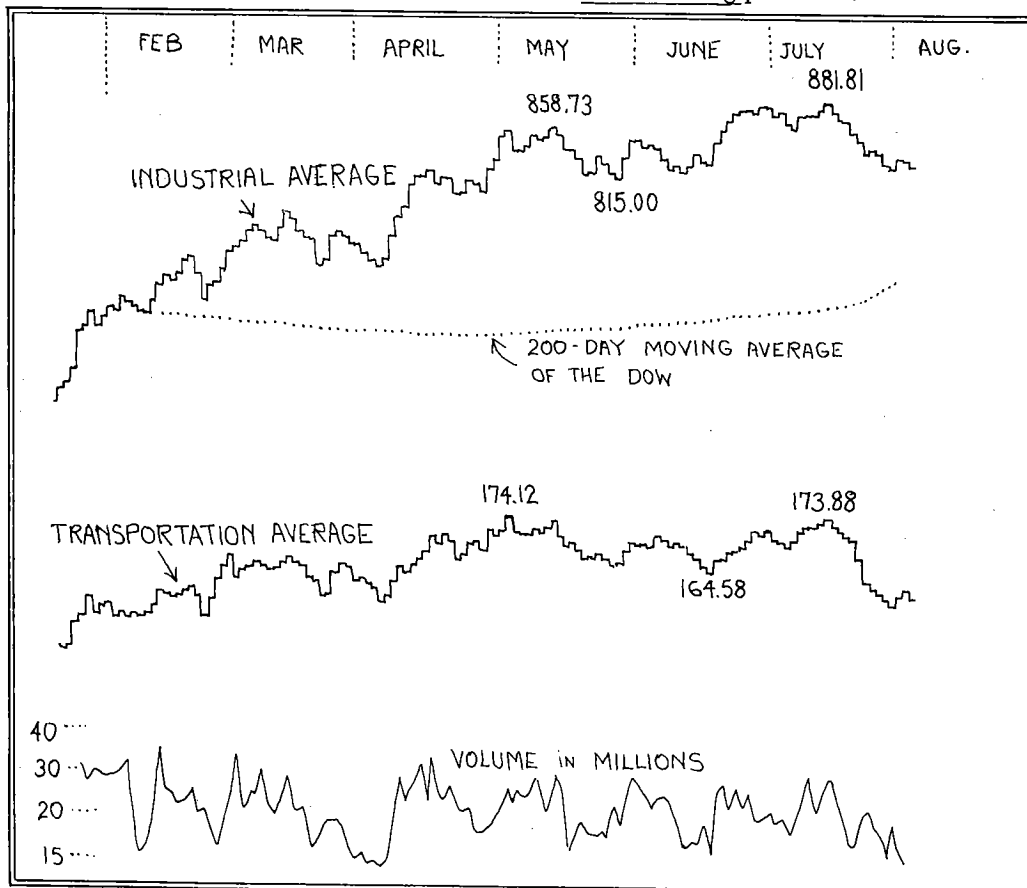
Wall Street can be a collection of charts or statistics, of profits or losses, or it can be a fascinating adventure into one of the toughest yet most rewarding fields in the world. At the end of the last report I published an excerpt by my old buddy Harry Schultz regarding why the great majority of advisory services fail and why a few seem to survive over the years. Well, the story is just about the same for investors.

The fact is that the great majority of "investors" lose their money in the market, while a select few seem to do very well over any given period of time. What's the dividing line; what's the difference between the winners and the losers? I've pondered that question for many years, and I believe that the answer is that the men who make money on Wall Street are the ones who deal with values but always within the framework of correct timing. The losers are the people who simply try to beat the market.

For instance, when we bought a long list of greatly depressed stocks last December, I wrote that these stocks either represented great values or Western civilization as we know it was about to drop into the abyss. The timing, the psychology, the news, the technical situation, everything suggested that stocks were being "given away" while the market was literally on the bottom. Thus we had an example of a situation in which we bought great values within the context of correct timing procedure.

I have found that Wall Street usually provides at least two advantageous "buy spots" per year. We had one such spot during the December-January period, and my guess is that we'll have another before 1975 is out (if I had to guess I'd say we'll have another good buy spot between October and December).

In January I presented studies (see chart page 2, courtesy of M/G Financial Weekly) of the "fifth year" according to the decennial pattern. The decennial pattern deals with decades such as 1940 to 1950, 1950 to 1960, etc., and it has been noted that comparable years (such as 1921, 1931, 1941, etc.,) tend to produce similar broad, repetitive patterns. I wrote that the fifth year (and, of course, 1975 is a fifth year) tends to be the most powerful of the decennial years, and so far 1975 has been no exception. Nevertheless, as seen on this series of



Note also that in the two most recent fifth years, 1955 and 1965, the corrections were short but sharp, and this could be what we are fated to see here in 1975.

However, I have the feeling that 1975 is going to produce something more akin to what I call the "July top syndrome." Going back through history I have found that when the market runs into trouble during July or early August, that trouble usually produces a fairly substantial reaction which does not hit bottom (call it the next "buy spot") until October through December. It's as if a July top finds the market saying, "I'm bothered by the picture over the next six months, and I think I'll just retreat until I feel safe. Even the new year (in this case, 1976) bothers me, so I think I'll get rid of as much stock as I can and then head South for the Fall."

For example, in 1933 the Dow topped at 106 on July 18. The bottom came on October 13 at 84. In 1938 the top came for the Dow on July 26 at 144. The Dow hit a September 5 low of 129. In 1941 we saw a July 28 Dow top of 130. The low came on December 23 at 106. In 1943 it was a July 5 top of 143 with a November 30 low of 129.

The year 1946 had an August 13 Dow peak of 203, followed by 163 for the Dow on October 9. In 1948 the Transports hit a peak on July 14 (Industrials had topped a month earlier at 193). By November 30 it was 171 for the Dow. In 1957 we saw a 520 peak for the Dow on July 12 (Bob Bleiberg, I guess we remember that one!). By October 26 the Dow halted its non-stop slide at 419. In 1959 it was an August 3 high of 678 for the Dow, and by November 16 the Dow had slid to 634. In 1967 the Dow topped at 926 on August 9. November 8 saw a low of 849 for the Dow.

So there you have it, a rundown on what happened in previous years when the market (following a strong first half year) topped in July or early August. In the great majority of cases, a substantial correction occurred. In the majority of cases, you could have sold out and gone on vacation until October or even December. So that's my best guess — if you've been afraid of going to Switzerland or Hawaii because you thought you'd miss the action, this is the time to pack your bags.

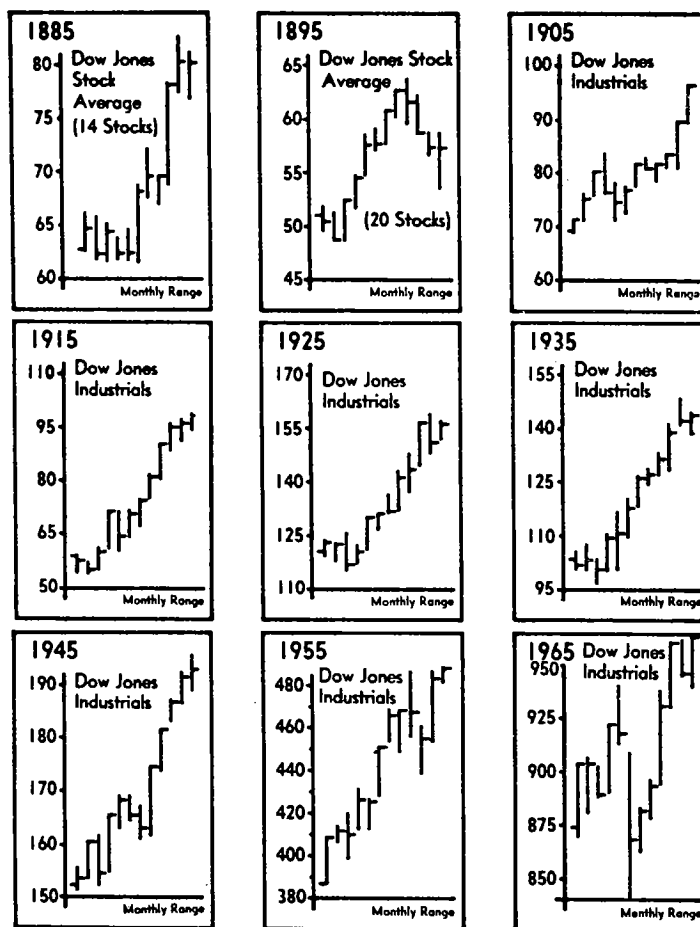
PRICE MOVEMENT: One of the reasons Dow's Theory lasts, but stock market advisories don't, is because Dow's Theory teaches us to let the market do the talking, while most of the advisories insist on the more egotistical approach of telling the market (and their subscribers) which way to go. Ultimately (and it doesn't take too long), the market ceases to follow the analyst's "predictions," and it's another sad statistic in the annals of the investment advisory business.

In the last Letter I noted that at the recent July 15 peak the Transportation Average had failed by a mere .24 to better its May 5 high. Those who doubted the validity of the confirmation principle received a swift and rather violent example of how it works. In just a few weeks the Transports have given back almost one-third of all their gains since the October, 1974 bear market low of 125.93. In doing so, the Transports have sunk to below levels not seen since mid-January.

The Industrial Average, however, has proved to be far more resistant to decline. May 5 was the day of the last joint highs for Industrials and Transports, and a market movement is taken to end at the point of the last confirmed highs. The lowest point for Industrials, following May 5, was the 815.00 low reached on May 29, and the comparable Transport low was the 164.58 bottom recorded on June 18. Those two points are the ones to watch, and I stated this in the last Letter.

Last week the Transports slumped well below the 164.58 level, but Industrials refused (by 12 points) to confirm. Thus the crucial current question is whether the Industrials Average will continue to hold above the 815.00 level, or whether the senior Averages is fated to follow the Transports below 815.00 to lower levels.

A persistent refusal by Industrials to penetrate 815.00 will set the stage for a probable trading area and ultimately an attack on the 1975 high. Conversely, a downside confirmation by Industrials would turn the secondary trend bearish and probably signal a major correction (particularly if volume expanded on a Dow slide below 815.00). But until the indications are more conclusive, it would be best (as it always is) to allow Wall Street to tell its own story in its own good time.



TECHNICAL NOTES: I have been saying that the index of cumulative most-active stocks (CMAS) was the strongest single technical area of this market. When it breaks its rising trend, I wrote, that will constitute a definite sign of market weakness. As you can see on the chart, the peak for CMAS was reached on July 15. Five trading days later CMAS plunged below its seven-month rising trendline. Meaning: The big money, the money that runs the most active stocks on the NYSE, has been moving towards the exits. It's as simple as that.

I also noted in the last Letter that the A-D ratio, having dropped over one point, had signalled the end of the second buying stampede. The decline in the A-D ratio to date has been quite severe, as you can see on the accompanying chart. In fact, the A-D has now dropped below the peak of the first buying stampede which ended on March 17. This is not particularly good action, and it implies that stocks purchased on or around March 17 are now (on average) below the March 17 levels. There's just nothing easy about this market, nothing at all!

Question: What do you think the recent Transport cave-in means? **Answer:** The Transports, composed of airlines, rails and truckers, are the vehicles that carry the goods. I think that the recent Transport sell-off is telling us that business is going to be disappointing this fall and winter, and that there are going to be a lot of half-filled trucks and freight cars moving around the country.

Question: How low could the Transport Average fall before you would consider this a bear market? **Answer:** Nothing the Transports alone could do would signal a bear market. That is the reason I presented the 1932-37 bull market study in Letter 636. As a matter of fact, the Transports could actually break to a new bear market low (below 125.93), and if Industrials refused to confirm (if they held above 577.60) it would still be a primary bull market.

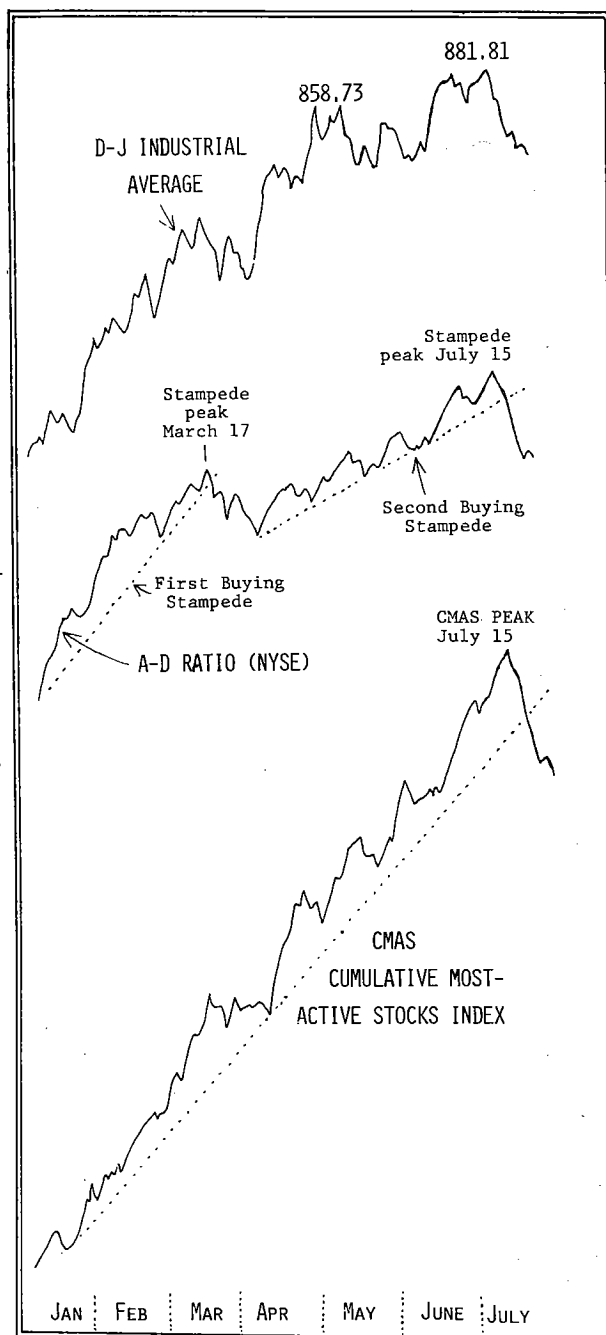
Question: Why do you use only closing prices in your studies of the Averages? **Answer:** Although the primary trend cannot be manipulated, the daily trend can be. Rumors, news, speculative excitement, all these can be used to manipulate the daily trend. But at the close many speculators and traders clear out their positions. Thus, the closing prices for the Averages show what has happened after all the day-traders and speculators have "cleaned house." That's the figure that Dow Theorists have used for almost 80 years.

NEGATIVE VOLUME: Back in 1933 Paul Dysart started a service called Trendway. Dysart did much pioneering work in breadth. His central index was termed the negative volume index (chart page 4), and it worked on a very simple and fundamental principle. Dysart reasoned that "informed money" prefers to buy and sell shares in quiet markets, whereas "uninformed money" tends to operate in active or excited markets. Working on this thesis, Dysart constructed an index for informed money which was based on the breadth plurality on any day in which NYSE volume was less than the preceding day's volume.

For example, if on Monday the NYSE volume was 18 million shares and up from Friday's 16 million shares, no entry was made in the negative volume index for Monday (because volume was up). Now, suppose Tuesday's volume dropped to 17 million shares and the plurality of advances over declines was 300. That action would add 300 to the negative volume index. All right, now Wednesday again shows a drop in Exchange volume to 15 million shares, and this time there are 420 more declines than advances; in this case 420 is subtracted from the negative volume index. Thursday produces volume of 20 million shares (up from Wednesday) so no entry is made.

Paul Dysart used the negative volume index to provide signals of changes of trend in the market. He believed that the negative volume index showed changes of primary significance. These signals were based on upward or downward zig-zag patterns of fairly substantial proportions. For instance, for a bull signal Dysart wanted a rally peak in the negative volume index, a decline of 1200 or more, then a rise to new highs. The reverse would be required for a bear signal.

Paul's son, Richard, now runs Trendway (PO Box 7184, Louisville, KY 40207), and Richard has added a number of new indices and interpretations to the old negative volume index, I have followed the original negative volume index for years (although I seldom



I have my own way of reading this index. I feel that with institutions now accounting for 70% of Exchange trading, there may be more difficulty in interpreting the meaning of negative volume signals, but they are nevertheless of great interest to me.

I include my chart of the Dow and negative volume showing all negative volume changes since August, 1974. The first interesting signal came in early October when negative volume (NV) pushed above the September peak (1 on chart). This was a rather small bullish structure, but it was the first bullish signal given by NV since the great 1973-74 smash. Then, inexplicably, in December (2 on chart) the NV index plunged to a new bear market low, corresponding to a new low in the Dow. This was followed by a sharp and impressive rally in NV. In early January NV gave a major bullish signal (at 3) by bettering the November high on the index. Here we had a large upward zig-zag, and I took it as a confirmation of a primary bull market.

On March 10 (4 on chart) NV gave an even more bullish and hopeful signal by bettering all preceding peaks going back to the October high. What this meant was that stocks were rising on expanding volume, but they were holding their gains on days of contracting volume. This is a phenomenon which I have often discussed, and it is a most important one. So important is this thesis that I want to repeat it again. "One of the most bullish technical developments in the market is a situation wherein stocks go up on rising volume, then hold their gains while volume contracts. This action always results in a bullish profile on the NV index.

From the March 10 peak (4), a most curious and extraordinary series of actions took place in NV. The index declined steadily all through March and April. On April 29 the NV index broke under the entire January to March level (at 5), thereby smashing to a new low for the entire period. Not only was NV at a new low for 1975, but it had dropped to the bear market bottom of December, 1974.

The new low in the NV gave me a strange feeling in the pit of my stomach. Frankly, I didn't like it at all. At best, it suggested that the secondary trend of the market was weakening badly. At worst it implied that something was wrong with the underlying technical structure of this market. The April 29 downside penetration on the NV should not have occurred in a technically strong bull market. Following point 5, the market rallied again, then turned down in a series of descending zig-zags. By late-July the negative volume index was far below the levels of last December or even the lower levels of May-June.

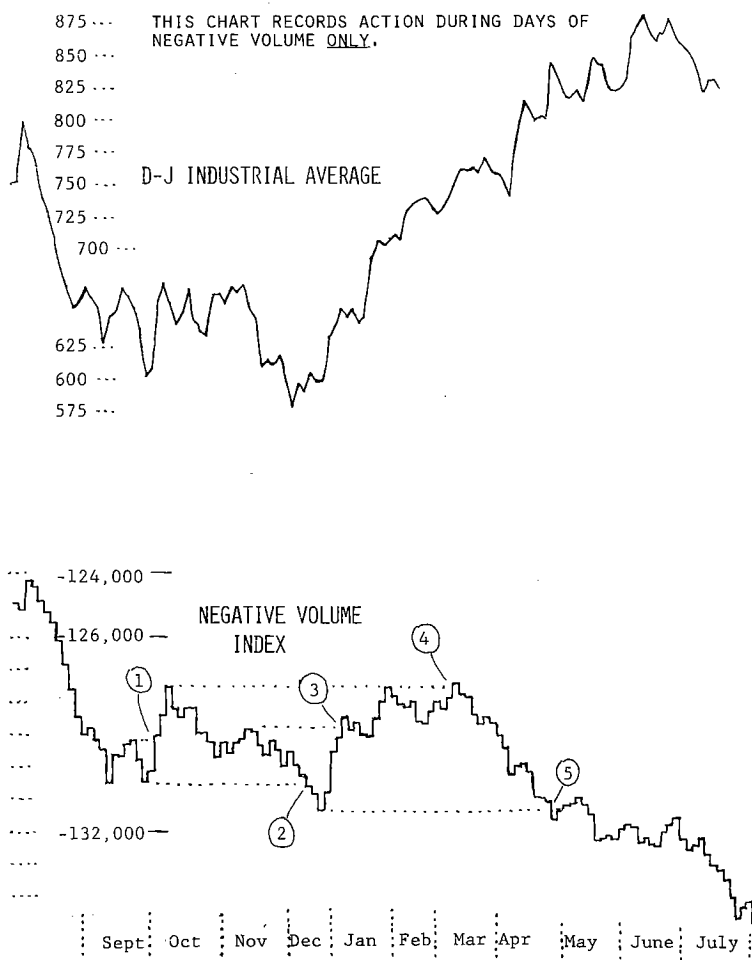
The only explanation I have for the important new lows in NV is that the monetary situation in this nation (as reflected in the market's technical structure) is extended, warped, out-of-kilter. It seems to me that the NV is pointing to unhealthy discrepancies and divergences which cannot be ignored. On top of this, the collapse of the Transportation Average over the past few weeks seems to be confirming what NV is saying. Is business going to remain flat, is New York City's plight a mere preview of what is going to emerge elsewhere among the 70,000 cities and municipalities in the US?

At any rate, if Paul Dysart were alive today, I believe he would take the new lows on NV as a bearish phenomenon, something to ponder about, something which was saying, "Pull your horns in." And I guess that's one reason why I've taken a rather cautious stance over the past few months.

GROUPS: In Letter 634 I reviewed the index of the number of stock groups advancing, and I said that when this index drops below the critical 50% level, I would let subscribers know it (see chart, page 5).

The composition of this index is simple enough, but what it says is very important. Each week I compute the percentage of the 34 Barron's groups which register a plus for the week (I leave out the gold group because it tends to be counter-cyclical), and I run these percentages in the form of an eight-week moving average. That's exactly what you see on the chart.

On the week ending January 10 this index pushed above the 50% level, which means that better than half of all the Barron's groups were in advancing trends. That's always a bullish situation, because it implies a broad move in the market, a rise that encompasses



From then on, the advancing percentages tended to drop off, but they did remain consistently above the 50% level.

Last week that changed. With only 18% of the groups rising last week (week ending August 1), the eight-week moving average sank to the 46% level. Thus, we have our first bearish reading on the groups-advancing index for 1975. Putting this together with the weakness in CMAS, the A-D ratio and the Transport Average, I would say that the secondary trend of the market is on wobbly footing. I now expect (based on past experience with this indicator) that we could see the index of the percentage of groups-expanding drop to the 20% to 30% level before it turns up and pushes convincingly to the bullish side. All of which is another way of saying that trouble lies ahead.

Question: Russell, you've given the advisory profession a hard time in this report. What do you really think of these gentlemen?

Answer: In my experience, all professions can be broken down as follows (and I don't care whether you're talking about doctors, lawyers, market analysts or structural designers). About 10% of the professionals will be outstanding, they will know their stuff. About 5% will be smart enough to copy the intelligent 10%. All the rest will be average to incompetent, but in general they should be avoided. Does that sound dismal? I would say that it is on the generous side.

But remember, no professional is going to be perfect in his field. If you're looking for perfection, forget it. The man who demands perfection has found the perfect way to frustrate himself and everyone else. Speaking of the top 10%, there are two outstanding technicians who I am now watching with great interest. These two men had their troubles during the bear market but they learned a great deal. They both fit into my personal adage which goes, "Watch the brilliant analyst who has been in trouble for a while. He is probably going to be the next one who is right (conversely, watch the guy who has been on the ball for a few years; he's probably going to be dead wrong on the next turn).

At any rate, Joe Granville and Martin Zweig have now issued sell bulletins and they are both bearish on the secondary trend. I won't argue with them, for I think they are going to be very right. I agree with them, and suggest great caution here and a scaling out of almost all equity.

Question: Isn't the low volume on this decline a bullish sign? **Answer:** The study on negative volume should answer that, but I'll add that all low volume is doing here is "locking in" millions of shares at higher prices, while letting nobody out of the secondary trap. If this market continues down, we'll get all the volume we want (probably in panic proportions).

Question: What do you make of the London market here? **Answer:** London is coming down hard. From the 1975 crash low of 147, London rose to a booming peak of 365. London has since corrected to 282. This means that London has lost 38% of its 1975 rise. London often leads the US. A similar drop in our market would take the Dow to the 760's. I think it could very easily occur.

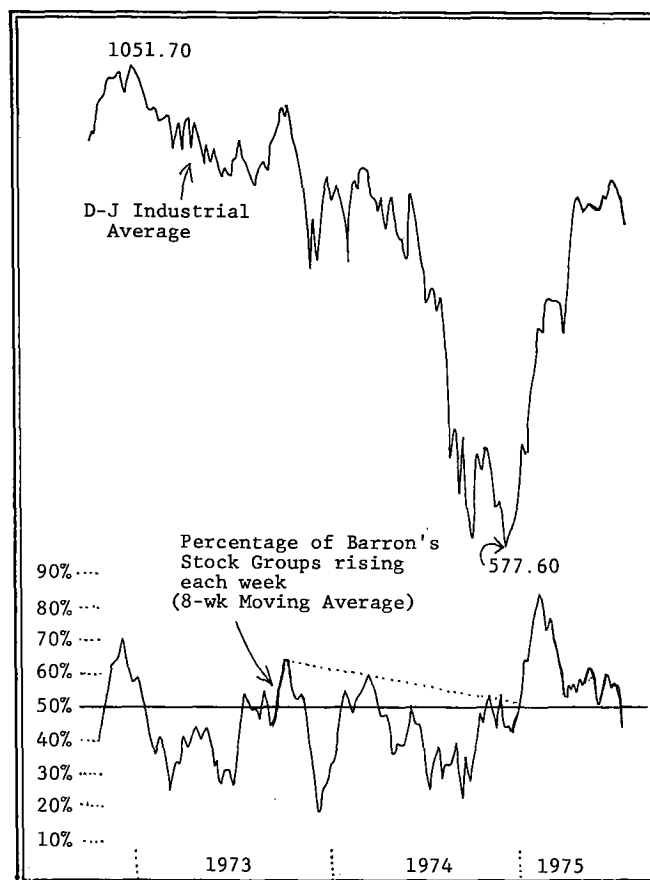
Question: What's your crystal ball view for the foreseeable future? **Answer:** The awful truth is that I don't know what's going to happen tomorrow, much less the "foreseeable future." But here's my best guess. I see the market going into an important secondary correction, with the decline lasting into October or beyond. I think business is going to take the decline badly, and that the economy is going to start sagging again (or at least any "pick-up" is going to be quite disappointing — and I've been saying this all year).

I feel the Fed will then move to ease up interest rates considerably (as they see that neither business nor the public is responding to the cash rebates and tax cuts). This should set off a substantial rise in the bond markets. It should also serve to put a top on the dollar, which has now risen (see Wall Street Journal clip of Aug 1) to a 17-month high.

* * *
The U.S. dollar hit a 17-month high on international currency markets, spurred by the improved American trade performance and higher U.S. interest rates.

Following the monetary easing (and perhaps renewed tax cuts, particularly for corporations), we should have a new stock market rise. What that advance looks like and how far it goes I can't foresee at this time. But we should have another good buy spot for stocks around the fourth quarter of 1975.

Question: How do you see New York City getting through this mess? **Answer:** Slowly, relentlessly, NYC and the rest of the nation are moving towards what Bernard Baruch used to term the thesis that "Two and two equals four." There is only one way out, and



Page 6 that way is unpolitical. The only answer is austerity, and it's coming. NYC is going to cut to the bone, or it's going to have to get Government help. The Administration knows the implications of dozens of big cities running to Washington with outstretched hands. So they're saying "No" to NYC.

The next result is going to be a confrontation between the City and reality — and the unions. The unions may win for a while longer, but they're fighting a losing battle. The battle can best be described by the current rock song, "Nothing from Nothing." The second half of the 1970's are going to be startling years, and they're going to see austerity. Fun City, USA, has the honor of leading the way.

When are we going to see austerity? If the Government inflates it will cut the consumers' buying power. If the nation deflates it will also cut the consumers' buying power (but the system will survive). Either way, the theme is going to be "cut back." And events are moving fast now, very fast.

My friend, Eliot Janeway, in his latest Janeway Service, has a few choice comments about NYC. "An interest default is now a clear danger. Suppose the banks get hit with one, but the unions only defer pay increases!" he asks. Janeway goes on, "Whatever happens, higher tax and transit charges will hit the consuming public. This is exactly what NYC's sick economy doesn't need." Later Janeway makes the ominous prediction, "The economy is in for a major shrinkage as state and local government functions are cut back; this has been the major source of dynamism in the American economy for some years. If governments can't bail themselves out, who can?" Don't ask me Eliot, I never wanted all the lousy government "service" (and the debt that goes with it), so don't ask me.

GOLD — WALKIN' DOWN THE LINE:

The bullion chart shows that gold may be getting ready for something on the upside, but the trend has not turned up yet. The 13-week moving average of bullion now stands at around 175, 9 points above the current price. On the point & figure chart a price of about 180 would be necessary to reverse the descending trendline. Silver (below gold) looks much more bullish, but

I feel that either gold will join silver on the upside or silver will fizzle. In the case of both silver and gold, however, I would say that the lows have been seen. Thus I see the greatest danger to holder stemming not from possible new lows, but from long, frustrating trading ranges.

Meanwhile, Homestake is walkin' the line, the rising trendline which started up in September, 1974. A price of 44 would definitely reverse HM to the downside, and I think it's coming. The gold play would seem to be in the bullion, not the shares, but here one must deal with no interest, no return, only the hopes of sharply rising prices. It's hardly a picture calculated to make a gold-man drool (chart of HM courtesy of Security Research, 208 Newbury St., Boston MA 02116).

STOCKS: I don't know of another field wherein people allow their emotions to so cloud their reasoning power. I'm talking about Wall Street. No matter what things look like, people insist on being in the market, insist that the market make money for them. I've stressed that there are usually two good buy spots a year, seldom more. If you can even get close to catching one or both spots, you could probably make a steady 15% to 30% annually on your capital. Of course, most investors make mistakes, come in too late, sell too late, sell too soon and then come in again. So over the years they usually don't average better than 15% on their money, but it can be done, and I know many people who do it.

We had a good buy spot in December-January, and we should be light or out now, awaiting a second opportunity. I think it's going to come during October to November, so that's what we'll wait for.

LATE NOTES: This is being written before the Monday, Aug. 4 closing. The Dow is down over 7 points while Transports are down another 2. The Dow is obviously flirting with the idea of breaking 815.00, and if so it will be most interesting to see whether we get some serious (increased volume) selling. The market is oversold here, but somehow I don't get the feeling of any impending "big action" on the upside. Next Letter will be mailed August 15th.

